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ARKANSAS PUBLIC SERVICE COMMISSION

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IN THE MATTER OF THE ANNUAL)
DETERMINATION OF THE INTEREST)
RATE APPLICABLE TO UTILITY)
CUSTOMER DEPOSITS)

DOCKET NO. 03-168-U

PREPARED TESTIMONY

OF

JOHNNY BROWN
FINANCIAL ANALYST

ON BEHALF OF THE
ARKANSAS PUBLIC SERVICE COMMISSION GENERAL STAFF

NOVEMBER 6, 2003

CUSTOMER DEPOSIT INTEREST RATE
DOCKET NO. 03-168-U
PREPARED TESTIMONY OF JOHNNY BROWN

BIOGRAPHY

1
2 **Q. Please state your name and business address.**

3 A. My name is Johnny Brown. My business address is the Arkansas Public Service
4 Commission (Commission or APSC), 1000 Center Street, Little Rock, Arkansas, 72201.

5 **Q. Please describe your present position with the Arkansas Public Service Commission**
6 **General Staff (Staff).**

7 A. I am employed by Staff as a Financial Analyst in the Financial Analysis Section. In that
8 capacity I perform economic and financial analysis, including determining the
9 appropriate relative relationship between debt and equity capital and calculating the cost
10 of debt, preferred stock and common equity as components for determining the overall
11 required rate of return for jurisdictional utilities. Additionally, I evaluate proposed debt
12 and equity issuances, mergers, and acquisitions pertaining to the Arkansas jurisdiction,
13 and monitor current economic and market trends and their impact on the cost of capital.

14 **Q. Please describe your education, work experience, and qualifications.**

15 A. I graduated from the University of Arkansas at Little Rock with a Bachelor of Business
16 Administration degree in Finance. For two years I worked in the financial services
17 industry as assistant to the investment manager at a local investment management firm.
18 My duties consisted of securities analysis, portfolio modeling, compiling and reporting
19 the financial statements of the company, quarterly billing, and managing the monthly
20 payroll tax withholdings. As my experience progressed, my responsibilities were
21 expanded to include the evaluation of investment portfolios to ensure that valuation and
22 performance characteristics were maintained based on the personal needs of the client

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1 and other economic and financial factors. Additionally, I was heavily involved in the
2 fundamental and technical analysis used to evaluate capital markets and specific
3 securities in order to make informed investment decisions.

4 During the time I have been employed by Staff, I have attended several regulatory
5 training seminars, including the two-week NARUC Annual Regulatory Studies Program
6 at Michigan State University, and the Utility Regulatory Training presented by the Center
7 for Public Utilities of New Mexico State University. I have also regularly attended the
8 annual Financial Forum sponsored by the Society of Utility and Regulatory Financial
9 Analysts, of which I am a member.

10 **Q. Have you previously testified before this Commission?**

11 A. Yes, I have testified before this Commission concerning the required return on equity and
12 cost of capital, customer deposit interest rate, and various financing transactions.

13 **PURPOSE**

14 **Q. What is the purpose of your testimony in this proceeding?**

15 A. The purpose of my testimony is to make a recommendation regarding the appropriate
16 2004 customer deposit interest rate, as directed by Commission Order No. 1 in this
17 Docket, dated October 7, 2003. This rate will apply to all jurisdictional utility companies
18 operating in Arkansas and subject to the Commission's authority.

19 **Q. Are you recommending a change in the 2.6% rate last authorized by this**
20 **Commission?**

21 A. Yes. I am recommending a customer deposit interest rate of 1.4%.

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CONSIDERATIONS

Q. What factors, including the appropriate statute, did you consider in arriving at your recommendation?

A. Ark. Code Ann. §23-4-206 (2002 Repl.) requires the Commission to determine, on an annual basis, the interest rate to be paid on customer deposits for utility service. The provision states that the annual rate of interest set by the Commission for any year shall not be more than ten percent (10%).

In accordance with Rule 4.01 of the Commission's *General Service Rules*, a utility customer can be required to deposit funds with the utility for the privilege of obtaining service. While the utility company has the discretion to request this deposit, the utility customer does not have the option of whether to comply or not, which makes the customer a forced investor. Given these conditions, the utility customer is not free to (1) decide whether or not to make the investment (deposit) in the utility or (2) select an alternative investment opportunity that might produce a higher rate of return. Therefore, the utility customer should be allowed a return on investment that would correspond to the return from a comparable investment. Rule 4.05 (A) of the Commission's *General Service Rules* mandates the payment of interest annually on utility deposits.

Q. What characteristics of the customer deposit did you consider relevant for identifying a comparable investment?

A. First, I evaluated the customer deposit from the perspective of an investment instrument. Since deposits in a utility are a relatively secure investment, a customer can be assured of principal repayment if the customer meets the requirements of Rule 4.06 of the

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1 Commission's *General Service Rules*. Thus, the principal amount of the deposit has a
2 minimal to non-existent default risk characteristic. Accordingly, a comparable
3 investment instrument would be one with little default risk.

4 Another characteristic of the deposit is its maturity, the length of the time the
5 utility has use of the funds before remitting them back to the customer. Rule 4.06 (A) of
6 the Commission's *General Service Rules* requires a utility to promptly refund the deposit
7 if the customer has "paid all bills by the due date for the last twelve months". Therefore,
8 consistent with Rule 4.06 (A), a comparable investment instrument should have a term of
9 one year.

10 **Q. Given these considerations, which investment instrument would best serve as a**
11 **reasonable proxy for estimating the appropriate return on utility customer**
12 **deposits?**

13 A. Considering principal risk, maturity, and the investment alternatives available to
14 Arkansas ratepayers, utility customer deposits are most comparable to certificates of
15 deposit. Accordingly, I selected a certificate of deposit with a principal amount of \$500
16 (which is generally the minimum balance) and a maturity of one-year to serve as a proxy
17 for customer deposits.

18 **Q. Has this approach to determining the annual customer deposit interest rate been**
19 **previously accepted by this Commission?**

20 A. Yes. The Commission has accepted this methodology since 1985 when it first began
21 establishing customer deposit interest rates.

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1 **Q. Has a survey of financial institutions in Arkansas concerning the interest rate paid**
2 **on a \$500, one-year certificate of deposit been conducted?**

3 **A. Yes. On October 31, 2003, a telephone survey of five financial institutions located**
4 **throughout Arkansas for their \$500, one-year certificate of deposit interest rates was**
5 **conducted. The average rate being paid by these five financial institutions was 1.4% with**
6 **a range of 1.2% to 1.5%. Attachment JB-1 presents the one-year certificate of deposit**
7 **interest rates by institution.**

8 **RECOMMENDATION**

9 **Q. What is your recommendation to this Commission regarding the customer deposit**
10 **interest rate to be paid by utility companies beginning January 1, 2004 and ending**
11 **December 31, 2004?**

12 **A. I am recommending that the Commission require all jurisdictional utilities to pay simple**
13 **interest at the rate of 1.4%.**

14 **Q. Does this conclude your testimony at this time?**

15 **A. Yes, it does.**

**CUSTOMER DEPOSIT INTEREST RATE
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ATTACHMENT JB-1

**\$500
ONE-YEAR
CERTIFICATE OF DEPOSIT INTEREST RATES
BY
FINANCIAL INSTITUTION**

FINANCIAL INSTITUTIONS	RATE
Community Bank of Cabot	1.4
Bank of Little Rock	1.5
Eagle Bank and Trust in Little Rock	1.3
Pulaski Bank and Trust in Little Rock	1.2
Pine Bluff National Bank	1.5
AVERAGE	1.4

Source:

Rates were compiled from a telephone survey of the
Financial Institutions, conducted October 31, 2003.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing has been served on all parties of record by forwarding the same by first class mail, postage prepaid, this 6th day of November, 2003.

Corinne J. Smith